1. FINANCIAL STATEMENT PRESENTATION

Introduction – The accompanying combined financial statements – statutory basis of the Commonwealth of Massachusetts (the Commonwealth) are presented in accordance with the requirements of Section 12 of Chapter 7A, as amended by Section 4 of Chapter 88 of the Acts of 1997 of the Massachusetts General Laws. The Office of the Comptroller also publishes the Commonwealth's Comprehensive Annual Financial Report (CAFR) which is prepared on the basis of generally accepted accounting principles (GAAP) for governments as prescribed by the Governmental Accounting Standards Board, the authoritative standard-setting body for establishing governmental accounting and financial reporting principles.

The combined financial statements – statutory basis include all budgeted and non-budgeted funds and account groups of the Commonwealth, as recorded by the Office of the Comptroller in compliance with Massachusetts General Laws and in accordance with the Commonwealth's budgetary principles.

The combined financial statements – statutory basis are not intended to include independent authorities, non-appropriated funds of higher education or other organizations included in the Commonwealth's reporting entity as it would be defined under GAAP.

Statutory Basis Accounting – The Commonwealth reports its statutory basis financial position and results of operations in funds and account groups, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues and expenditures/expenses. Transactions between funds within a fund type, if any, have not been eliminated.

Account groups are accounting entities used to provide accountability for the Commonwealth's general fixed assets and long-term obligations. They are not considered funds because they do not report expendable available financial resources and related liabilities.

The Fund types and account groups are organized as follows:

Governmental Fund Types **-** accounts for the general governmental activities of the Commonwealth.

Budgeted Funds – are the primary operating funds of the Commonwealth. They account for all budgeted governmental transactions. Major budgeted funds include the General, Highway and Local Aid funds which are identified by the Comptroller as the operating funds of the Commonwealth.

Non-Budgeted Special Revenue Funds – are established by law to account for specific revenue sources that have been segregated from the budgeted funds to support specific governmental activities such as federal grants and the operations of the state lottery.

Capital Projects Funds – account for financial resources used to acquire or construct major capital assets and to finance local capital projects. These resources are derived from proceeds of general obligation bonds which are generally received after the expenditure has been incurred, operating transfers authorized by the Legislature and from federal reimbursements. Deficit balances in Capital Projects Funds represent amounts to be financed.

Fiduciary Fund Types **–** account for assets held by the Commonwealth in a trustee capacity (Trust Funds), or as an agent (Agency Funds) for individuals, private organizations, other governmental units, and/or other funds.

Expendable Trust Funds – account for trusts whose principal and investment income may be expended for their designated purpose.

Nonexpendable Trust Funds – account for trusts whose principal cannot be spent.

Pension Trust Funds – account for the net assets available for plan benefits held in trust for the State Employees' and Teachers' Retirement Systems.

Agency Funds – account for assets the Commonwealth holds on behalf of others. Agency Funds are custodial in nature and do not involve measurement of operations.

Account Groups – establish control and accountability over the Commonwealth's general fixed assets and long-term obligations.

General Fixed Assets Account Group – accounts for the general fixed assets of the Commonwealth and Capital Leases.

General Long-term Obligations Account Group – accounts for long-term bonds and notes issued by the Commonwealth and capital leases.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Statutory Basis of Accounting – The Statutory Basis Financial Report is prepared from the Commonwealth's books and records and other official reports which are maintained on the basis of accounting used in the preparation of the Commonwealth's legally adopted annual budget (statutory basis). The statutory basis emphasizes accountability and budgetary control of appropriations. The Statutory Basis Financial Report is not intended to present the Commonwealth's financial condition and results of operations in conformity with GAAP. Under GAAP, the books are accounted for using a current financial resources measurement focus and the modified accrual basis of accounting.

Revenues are generally recognized when cash deposits are received by the Treasury. However, revenues receivable for federal grants and reimbursements are recognized when related expenditures are incurred. Amounts due from political subdivisions of the Commonwealth are recognized when considered measurable and available. Deeds excise taxes are recognized at the time of collection by the counties and the Commonwealth. Under GAAP, revenues are recognized when they become both measurable and available.

Expenditures are generally recorded when the related cash disbursement occurs. At year-end, payroll is accrued and payables are recognized, to the extent of approved encumbrances, for goods or services received by June 30. Costs incurred under the federally-sponsored Medicaid program, amounts required to settle claims and judgments against the Commonwealth, and certain other liabilities are not recognized until they are encumbered or otherwise processed for payment. Under GAAP, expenditures are recorded in the period in which the related fund liability is incurred.

The Pension Trust Funds are reported using a flow of economic resources measurement focus and the accrual basis of accounting on both the Statutory and GAAP basis. Under this method, additions are recorded when earned and deductions are recorded at the time liabilities are incurred. This measurement focus emphasizes the determination of net changes in assets available for pension benefits.

The accounting policies followed in preparing the accompanying combined financial statements – statutory basis are described as follows.

Cash, Short-term Investments and Investments –

The Commonwealth follows the practice of pooling the cash and cash equivalents of its Governmental and Fiduciary Funds. Cash equivalents consist of short-term investments with an original maturity of three months or less and are stated at cost. Interest earned on pooled cash is allocated to the General Fund, Expendable Trust Funds and to certain Special Revenue and Capital Projects Funds when so directed by law.

The Commonwealth enters into interest rate swap agreements to modify interest rates on outstanding debt. Other than the net interest expenditures resulting from these agreements no amounts are recorded in the financials statements.

The Pension Trust Funds, with investments total approximately $26,884,000,000 at fair value, are permitted to make investments in equity securities, fixed income securities, real estate and other alternative investments. For investments traded in an active market, the fair value of the investment will be its market price. The Pension Trust Funds include investments in real estate, venture capital funds, real estate funds, limited partnerships, futures pools, international hedge pools, commodities pools, balanced pools, leveraged buyouts, private placements and other alternative investments. The structure, risk profile, return potential and marketability differ from traditional equity and fixed income investments. Concentration of credit risk exists if a number of companies in which the fund has invested are engaged in similar activities and have similar economic characteristics that could cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. To mitigate the exposure to concentrations of risk, the Pension Trust Funds invest in a variety of industries located in diverse geographic areas. As of June 30, 1999, the estimated fair values, determined by management with input from the investment managers, of these real estate and alternative investments were $2,481,029,000 of the Pension Trust Funds, representing 7.7% of the total assets of the Fiduciary Fund Type.

***Securities Lending Program* -** The Pension Trust Funds participate in securities lending programs. Under these programs, the Trusts receive a fee for allowing brokerage firms to borrow certain securities for a predetermined period of time, securing such loans with cash or collateral typically equaling 102% to 105% of the fair value of the security borrowed. At June 30, 1999, the market value of the securities on loan from the Pension Reserve Investment Trust (PRIT) was approximately $1,292,000,000. The value of the collateral held by PRIT amounted to $1,394,000,000 at June 30, 1999. The PRIT securities on loan were collateralized at all times by U.S. Treasury securities of at least 100% of the value.

Receivables – Receivables are stated net of estimated allowances for uncollectible accounts. Reimbursements due to the Commonwealth for its expenditures on federally funded reimbursement and grant programs are reported as "Due from federal government."

Due from Cities and Towns – Represents reimbursement due to the Commonwealth for its expenditures on certain programs for the benefit of cities and towns.

Advances to Related Entity – The Commonwealth periodically provides working capital advances to the Massachusetts Bay Transportation Authority (MBTA) to fund its net cost of service. These advances are repaid through subsequent appropriations by the Legislature and assessments to cities and towns for their respective shares of the MBTA's net cost of service.

Inventories – The costs of materials and supplies are recorded as expenditures in Governmental Funds when purchased. Such inventories are not material in total to the financial statements and therefore are not recorded.

General Fixed Assets – General fixed asset acquisitions are recorded as expenditures in the acquiring fund and capitalized in the General Fixed Assets Account Group in the year purchased. General fixed assets are recorded at historical cost, or at estimated historical cost if actual historical cost is not available. Donated fixed assets are recorded at estimated fair market value at the date of donation.

The cost of normal maintenance and repairs that do not add to the value of the assets or materially extend asset lives are not capitalized. Improvements are capitalized.

The Commonwealth capitalizes all land except land associated with infrastructure. It capitalizes buildings and equipment, including computer software, with costs in excess of fifteen thousand dollars at the date of acquisition and with expected useful lives greater than one year. Interest incurred during construction is not material and is not capitalized. Public domain general fixed assets and infrastructure (roads, bridges, tunnels, dams, water and sewer systems, etc.) are not capitalized. No depreciation is provided on general fixed assets.

Interfund/Intrafund Transactions – During the course of its operations, the Commonwealth records transactions between funds and/or between departments. On the statutory basis, transactions between Governmental and Fiduciary Fund Types are recorded as adjustments to the funds' cash accounts. As a result, a fund may report a deficiency in cash and short-term investments.

Transactions of a buyer/seller nature between departments within a fund are not eliminated.

Transfers in and out net to $5.6 million due to higher education non-appropriated fund activity, which is not included in the combined statements – statutory basis.

Risk Management – The Commonwealth does not insure for state employees workers' compensation, casualty, theft, tort claims and other losses. Such liabilities are not recognized on the statutory basis until encumbered and/or processed for payment. For employees workers' compensation, the Commonwealth assumes the full risk of claims filed under a program managed by the Human Resources Division. For personal injury or property damages, Chapter 258 of the Massachusetts General Laws (General Laws) limits the risk assumed by the Commonwealth to $100,000 per occurrence, in most circumstances. The Group Insurance Commission administers contributory health care and other insurance programs for the Commonwealth's employees and retirees.

The Commonwealth has entered into agreements for insurance for Central Artery/Tunnel Project workers' compensation and certain other claims that may arise in the course of the Project. This special arrangement has been approved by the Federal Highway Administration as a cost-effective method to fund current and potential future claims by contractors, workers, and other parties affected by the project. Pursuant to the agreement, the Commonwealth conveys a sum of money to the agent each month. This amount includes both federal and state share. The agent manages and settles all claims. At the conclusion of the program, the balance remaining, if any, will be returned to the Commonwealth and the federal government. The monthly amount conveyed to the agent is accounted for (on the statutory basis of accounting) as an expenditure in the Federal Highway Capital Projects Fund.

Encumbrances – Encumbrance accounting is utilized in the Governmental Fund Types as a significant aspect of budgetary control. The full amounts of purchase orders, contracts and other commitments of appropriated resources are encumbered and recorded as deductions from appropriations prior to actual expenditure, ensuring that such commitments do not exceed appropriations. Encumbrances outstanding at year-end for goods or services received on or before June 30 are reported as statutory basis liabilities and expenditures.

Fringe Benefit Cost Recovery – The Commonwealth appropriates and pays the fringe benefit costs of its employees and retirees through the General Fund and the Intragovernmental Service Fund. These fringe benefits include the costs of employees' health insurance, pensions, unemployment compensation, and other costs necessary to support the state work force. As directed by Chapter 29, Sections 5D and 6B(f) of the Massachusetts General Laws, these costs are assessed to other funds based on their payroll costs, net of credits for direct payments. Since these fringe benefit costs are not appropriated in the budget, the required assessment creates a variance between budget and actual expenditures at year end. The fringe benefit cost recoveries of $121,376,000 in the budgeted funds are offset by fringe benefit costs assessments of $66,338,000 in the governmental fund types and the expendable trust funds. The remainder of $55,038,000 is assessed to the higher education non-appropriated activity which is not included in the combined financial statements - statutory basis.

School Construction Grants - The Commonwealth, through legislation, is committed to reimburse certain cities, towns and regional school districts for a portion of their debt service costs for school construction and renovation. These costs are recorded as expenditures when paid. The amounts expected to be liquidated with available financial resources are reported as expenditures and fund liabilities under GAAP. The long-term portion of this liability is recorded in the General Long-Term Obligation Account Group on a GAAP basis.

Compensated Absences – Employees are granted vacation and sick leave in varying amounts based on collective bargaining agreements and state laws. Upon retirement, termination or death, certain employees are compensated for unused vacation and sick leave (subject to certain limitations) at their then-current rate of pay. Vacation and sick leave are recorded as expenditures when paid.

Lottery Revenue and Prizes – Ticket revenues and prizes awarded by the Massachusetts Lottery Commission are recognized as drawings are held. For certain prizes payable in installments, the Commonwealth purchases annuities, "principal only" and "interest only" treasury strips in the Commonwealth's name, which are recorded as annuity contracts and prizes payable in the Agency Funds on a GAAP basis. The Commonwealth retains the risk related to such annuities.

Fund Balances – The Commonwealth reports fund balances as reserved where legally restricted for a specific future use. Otherwise, these balances are considered unreserved.

Fund balance has been reserved as follows:

"Reserved for continuing appropriations" – are unexpended amounts in appropriations which the Legislature has specifically authorized to be carried into the next fiscal year.

"Reserved for Commonwealth stabilization" – are amounts set aside in the Commonwealth Stabilization Fund in accordance with 5C of Chapter 29 of Massachusetts General Laws.

"Reserved for tax reduction" - is the amount set aside in the Tax Reduction Fund according to Section 6 of Chapter 29B of the Massachusetts General Laws and amount set aside in the Tax Escrow Fund to fund the FY98 portion of permanent tax reductions authorized by Chapter 175 of the Acts of 1998.

"Reserved for transitional escrow" – are reserves set aside until December 31, 1999 under Section 46 of Chapter 68, Acts of 1999.

"Reserved for debt service" – are amounts held by fiscal agents or the Commonwealth to fund future debt service obligations.

"Reserved for employees' pension benefits" – are the net assets of the Commonwealth's public employee retirement systems which cannot be used for any other purpose.

"Reserved for unemployment benefits" – are amounts reserved for payment of unemployment compensation.

"Reserved for capital projects" - are amounts reserved for capital projects.

Unreserved fund balance is segregated into two components:

"Designated for specific purpose" – are all unreserved fund balances for which the Legislature or Executive Branch has evidenced an intention to restrict for a specific purpose.

"Undesignated" – consists of cumulative surpluses or deficits of the Governmental Fund Types not otherwise designated.

Reclassification – Certain reclassifications have been made to the 1998 account balances to conform to the presentation used in 1999.

3. BUDGETARY CONTROL

State finance law requires that a balanced budget be approved by the Governor and the Legislature. The Governor presents an annual budget to the Legislature which includes estimates of revenues and other financing sources and recommended expenditures and other financing uses. The Legislature, which has full authority to amend the budget, adopts an expenditure budget by appropriating monies at the individual appropriation account level in an annual appropriations act.

Before signing the appropriations act, the Governor may veto or reduce any specific item, subject to legislative override. Further changes to the budget established in the annual appropriations act may be made via supplemental appropriations acts or other legislative acts. These must also be signed by the Governor and are subject to the line item veto.

In addition, Massachusetts General Laws authorize the Secretary of Administration and Finance, with the approval of the Governor, upon determination that available revenues will be insufficient to meet authorized expenditures, to withhold allotments of appropriated funds which effectively reduce the account's expenditure budget.

The majority of the Commonwealth's appropriations are non-continuing accounts which lapse at the end of each fiscal year. Others are continuing accounts for which the Legislature has authorized that an unspent balance from the prior year be carried forward and made available for spending in the current fiscal year. In addition, the Legislature may direct that certain revenues be retained and made available for spending within an appropriation to allocate fringe benefits and other costs which are mandated by state finance law are not itemized in the appropriation process or separately budgeted.

The original fiscal year 1999 appropriations act was Chapter 194, Acts of 1998. This appropriation act authorized $18,717,021,000 in direct appropriations. In addition, the act contained $810,540,000 in authorizations to retain and expend certain non-tax revenues of which $800,120,000 were estimated to be collected and expended, plus $106,849,000 of interagency chargebacks. Chapter 194 included estimates of $13,870,500,000 in tax revenues and approximately $5,644,200,000 in non-tax revenues. With these revenues (exclusive of chargebacks) projected to total approximately $19,514,700,000 and with unreserved balances of approximately $378,527,000 carried forward from the fiscal year 1998, the budget as presented in this original appropriation act was considered to be in balance.

During fiscal year 1999, the Legislature also passed and the Governor signed, with some modification through veto, Chapters 319, 386, 399, 481 and 482 of the Acts of 1998, and Chapters 10, 20, 22 and 26 of the Acts of 1999, which included numerous supplemental budgetary appropriations. These supplements added $954,000 in direct appropriations and $207,319,000 in additional retained revenue authorizations and $2,192,000 in additional interagency chargebacks.

Subsequent to June 30, 1999 the Legislature passed and the Governor signed Chapters 55 as amended and 68 of the Acts of 1999 which included $95,703,000 in additional supplemental appropriations, $605,720,000 in additional retained revenue authorizations. The cumulative fiscal year 1999 appropriations, retained revenues, and interagency chargebacks totaled $20,546,299,000. Appropriations continued from fiscal year 1998 totaled approximately $260,289,000 and certain interfund transfers directed by statute totaled approximately $1,111,042,000.

Because revenue budgets are not updated subsequent to the original appropriation act, the comparison of the initial revenue budget to the subsequent, and often modified, expenditure budget can be misleading. Also, these financial statements portray fund accounting with gross inflows and outflows, thus creating a discrepancy to separately published budget documents. In conducting the budget process, the Commonwealth excludes those interfund transactions that by their nature have no impact on the combined fund balance of the budgeted funds.

Generally, expenditures may not exceed the level of spending authorized for an appropriation account. However, the Commonwealth is statutorily required to pay debt service, regardless of whether such amounts are appropriated. In addition, certain interfund assessments to allocate fringe benefits and other costs which are mandated by state finance law are not itemized in the appropriation process or separately budgeted.

The following table identifies this interfund activity from the budgeted sources and uses to align more clearly forecasts prepared during the budget process to the detailed fund accounting of the Commonwealth's statutory financial statements (amounts in thousands):

	Revenues and Other Financing Sources	Expenditures and Other Financing Uses
Actual as presented in the combined budget and actual statement - statutory basis	$ 21,566,991	$ 21,646,656
Adjustments to revenues and expenditures		
Municipal transit assessments	(159,916)	(159,916)
Transfer to the Intragovernmental Service Fund Revenues	(96,860)	(96,860)
Adjustments to other financing sources and uses:		
MBTA subsidy transfer	(135,343)	(135,343)
Fringe benefit cost assessments	(23,309)	(23,309)
Transfer from the Intragovernmental Service Fund to the General Fund	(2,516)	(2,516)
Transfer from the Revenue Maximization Fund to the General Fund	(49,809)	(49,809)
RMV License Plates	(1,939)	(1,939)
Stabilization transfers	(165,622)	(165,622)
Transfer from Tax Exemption Escrow Trust Fund	(171,018)	(171,018)
Transfer to Transitional Escrow Fund	(92,000)	(92,000)
Collective Bargaining Reserve Fund	(86,000)	(86,000)
Transfer from Tax Reduction Fund	(208,800)	(208,800)
Transfer to Close Health Care Access Fund	(23,105)	(23,105)
Transfer to Close Commonwealth Economic Development Fund	(355)	(355)
Transfer to Close Re-Employment and Job Placement Fund	(2,539)	(2,539)
Transfer from General to Children's and Senior's Health Fund	(36,952)	(36,952)
MWRA Debt Service Reimbursement	(4,435)	(4,435)
Transfer to Child Care Fund	(91,874)	(91,874)
Transfer to Social Services Program Fund	(45,937)	(45,937)
Transfer to Inland Fisheries and Game Fund	(97)	(97)
Transfer to Caseload Mitigation Fund	(3,461)	(3,461)
Actual as presented on budgetary documents	$20,165,104	$20,244,769

Please see section divider for the budgeted funds to review the list of budgeted funds grouped by categories.

The Office of the Comptroller has the responsibility to ensure that budgetary control is maintained on an individual appropriation account basis. Budgetary control is exercised through the state accounting system, Massachusetts Management Accounting and Reporting System (MMARS). Encumbrances and expenditures are not allowed to exceed the appropriation account's spending authorization.

4. DEPOSITS AND INVESTMENTS

The Commonwealth maintains a cash and short-term investment pool that is available for use by all funds. Each fund type's net equity in this pool is displayed on the combined balance sheet as either "Cash and short-term investments" or "Deficiency in cash and short-term investments." The investments of the Pension Trust Funds are held in a trust.

The Office of the Treasurer and Receiver-General (the "Treasury") manages the Commonwealth's short-term investment pool. Statutes authorize investment in obligations of the U.S. Treasury, authorized bonds of all states, banker's acceptances, certificates of deposit, commercial paper rated within the three highest classifications established by Standard & Poor's Corporation and Moody's Commercial Paper Record and repurchase agreements that any of these obligations secure. Such investments are carried at cost, which approximates fair value.

The pooled cash and short-term investments at June 30, 1999 are as follows (amounts in thousands):

	Carrying Value
Cash and Certificates of deposit	$ 361,358
Short-term investments:	
U.S. Treasury obligations	917,291
Commercial paper	1,831,072
Short-term investment pool	1,000,000
Repurchase agreements	611,947
Total	$ 4,721,668

Pooled cash and short-term investments include the following:

Cash and short-term investments	$ 7,527,398
Cash with fiscal agent	75,165
Deficiency in cash and short-term investments	(2,880,895)
Total	$ 4,721,668

The Pension Trust Funds have invested a significant

portion of their portfolios into a trust, which pools assets for investment purposes and allocates returns on these investments in proportion to each fund's share of the pool.

The investments are carried at fair value. At June 30, 1999, they are as follows (amounts in thousands):

	Amount
Investments:	
Equity securities	$ 12,882,016
U.S. government and government agency securities	2,780,953
Fixed income securities	3,054,631
Real estate	1,313,761
Alternative investments	1,167,268
International investments	5,685,442
Total	$ 26,884,071

***Financial Instruments with Off-Balance Sheet Risk* -** Certain investments of the Commonwealth may involve a degree of risk not accounted for on the respective financial statements. A description of such "off-balance sheet risks" are as follows:

***Forward Currency Contracts* -** The Pension Trust Funds enter into forward currency contracts to hedge the exposure to change in foreign currency exchange rates on foreign portfolio holdings. The market value of the contract will fluctuate with changes in currency exchange rates. Risks may arise upon entering these contracts from the potential inability of counterparties to meet the terms of their contracts and from unanticipated movements in the value of a foreign currency relative to the U.S. dollar.

When the contract is closed, the Pension Trust Funds record a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed. Fluctuations in the value of forward currency contracts are recorded as unrealized gains or losses by the Pension Trust Funds.

***Future Contracts* -** The Pension Trust Funds may purchase and sell financial futures contracts to hedge against changes in the values of securities the fund owes or expects to purchase. Upon entering such contracts, they must pledge to the broker an amount of cash or securities equal to a percentage of the contract amount.

The potential risk is that the change in the value of futures contracts primarily corresponds with the value of underlying instruments which may correspond to the change in value of the hedged instruments. In addition, there is a risk that PRIT may not be able to close out its future positions due to a non-liquid secondary market. Risks may arise from the potential inability of a counter-party to meet the terms of a contract and from unanticipated movements in the value of a foreign currency relative to the U.S. dollar. The Pension Trust Funds may also invest in financial futures contracts for non-hedging purposes.

Payments are made or received by the Pension Trust Funds each day, depending on the daily fluctuations in the value of the underlying security and are recorded as unrealized gains or losses. When the contracts are closed, the Pension Trust Funds recognize a realized gain or loss.

***Options* -** PRIT is also engaged in selling or "writing" options. The Pension Trust Funds, as writers of options, may have no control over whether the underlying securities may be sold (call) or purchased (put) and, as a result, bears the market risk of an unfavorable change in the price of the security underlying the written option. As of June 30, 1999, there were no material options outstanding.

5. SHORT-TERM FINANCING AND CREDIT AGREEMENTS

Massachusetts General Laws authorize the Treasurer to issue temporary notes in anticipation of revenue or bond financing. When this short-term debt does not meet long-term financing criteria, it is classified among fund liabilities.

General Fund – The Commonwealth is authorized by Massachusetts General Laws to issue short-term notes to finance working capital advances to the MBTA. The Commonwealth retires these notes through subsequent appropriations and assessments to cities and towns. There were no such notes outstanding at June 30, 1999.

The balance of revenue anticipation notes (RANs) outstanding fluctuates during the fiscal year, but must be reduced to zero at June 30. During fiscal year 1999, there were no RANs issued or outstanding.

Capital Projects Funds – The Commonwealth may issue bond anticipation notes (BANs) to temporarily finance its capital projects. During fiscal year 1999, there were no BANs issued or outstanding.

Letter-of-Credit Agreements – During fiscal year 1999, the Commonwealth maintained letter-of-credit agreements with several banks in order to provide credit and liquidity support for its commercial paper program. The letters of credit were available to secure up to $400,000,000 of Commonwealth commercial paper plus interest thereon. Advances were available, subject to certain limitations and bearing interest at the bank rate as defined, in anticipation of revenue or bond proceeds and repayable by the following June 30, subject to extension in certain circumstances, at the Commonwealth's option. No such advances were drawn during the fiscal year ended June 30, 1999, or subsequent thereto. One $200,000,000 letter of credit agreement expired on September 1, 1998. The remaining agreement expires on October 31, 2000. The average costs are approximately .09% on both unutilized and utilized amounts

Line-of-Credit Agreement – During fiscal year 1999, the Commonwealth did not maintain any line-of-credit agreements to provide liquidity support for commercial paper notes. On September 28, 1999, the Commonwealth entered into line-of-credit agreements with two banks to provide a total of $400,000,000 in liquidity support for the state's commercial paper program. These agreements expire in September of 2001 and 2002, respectively. The costs of these facilities average approximately .08% on unutilized amounts and .095% on utilized amounts.

6. LONG-TERM DEBT

Under the Constitution of the Commonwealth of Massachusetts, the Commonwealth may borrow money (a) for defense, (b) in anticipation of receipts from taxes or other sources, any such loan to be paid out of the revenue of the year in which the loan is made, or (c) by a two-thirds vote of the members of each house of the Legislature present and voting thereon. The Constitution further provides that borrowed money shall not be expended for any other purpose than that for which it was borrowed or for the reduction or discharge of the principal of the loan. In addition, the Commonwealth may give, loan or pledge its credit by a two-thirds vote of the members of each house of the Legislature present and voting thereon, but such credit may not in any manner be given or loaned to or in aid of any individual, or of any private association, or of any corporation which is privately owned or managed.

The Commonwealth has waived its sovereign immunity and consented to be sued on contractual obligations, including bonds and notes issued by it and all claims with respect thereto. However, the property of the Commonwealth is not subject to attachment or levy to pay a judgment, and the satisfaction of any judgment generally requires legislative appropriation. Enforcement of a claim for the payment of principal or interest on bonds and notes of the Commonwealth may also be subject to the provisions of federal or Commonwealth statutes, if any, enacted to extend the time for payment or impose other constraints upon enforcement.

As of June 30, 1999, the Commonwealth had three types of long-term debt outstanding: general obligation bonds, special obligation bonds and grant anticipation notes.

The general obligation bonds are authorized and issued primarily to provide funds for Commonwealth-owned capital projects and local government improvements. They are backed by the full faith and credit of the Commonwealth and paid from the Governmental Funds, in which debt service principal and interest payments are appropriated. Massachusetts General Laws provide for the allocation of bond proceeds to these authorizations in arrears, as expenditures are made, unless the proceeds are allocated at the time of issuance.

Some Commonwealth general obligation debt is issued as college opportunity bonds (COBs) as authorized by the Massachusetts General Laws. Such bonds were issued in fiscal years 1996, 1997, 1998 and 1999 in initial amounts totaling $82,578,000, with maturities ranging from 2000 through 2018. COBs have an accreting interest component payable at maturity. The annual accretion rate of each COB's maturity is a variable rate equal to the change in annual Consumer Price Index (CPI) plus 2.0%. Assuming the CPI averages 3.5% during the life of the outstanding COBs the payments due at maturities of the COBs will total $144,344,000. In addition, COBs pay current interest in the amount of 0.5% per year of the initial amount still outstanding. These bonds are backed by the full faith and credit of the Commonwealth.

On August 1, 1999 the Commonwealth issued approximately $12,900,000 in additional College Opportunity Bonds, with maturities of 2004 to 2019. The terms and conditions of these bonds are the same of those issued in fiscal years 1996, 1997, 1998 and 1999.

Chapter 38 of the Acts of 1997 and Chapter 300 of the Acts of 1998 abolished several Massachusetts counties on various effective dates. As part of these provisions, the Commonwealth assumed the outstanding debt of

Middlesex County on July 1, 1997, and that of Hampden and Worcester Counties on July 1, 1998. As of June 30, 1999, $2,345,000 of these obligations remains outstanding. On July 1, 1999 the Commonwealth assumed the debt of Essex County in the amount of $2,100,000.

The Commonwealth also issues special obligation revenue bonds as authorized by Massachusetts General Laws. Such bonds may be secured by all or a portion of revenues credited to the Highway Fund and are not general obligations of the Commonwealth. At June 30, 1999, the Commonwealth had outstanding $585,730,000 of such special obligation bonds, secured by a pledge of 6.86 cents of the 21 cent motor fuel excise tax imposed on gasoline. No new special obligation bonds were issued during the fiscal year.

The Commonwealth also issues Federal Highway Grant Anticipation Notes (GANS) to finance current cash flow for the Central Artery/Tunnel Project in anticipation of future federal reimbursements. Section 9 through 10D of Chapter 11 of the Acts of 1997, as amended by Chapter 121 of the Acts of 1998, authorizes the Commonwealth to sell up to $1,500,000,000 in GANS. All Federal Highway Construction reimbursements and reimbursements from the federal highway constructions trust funds are pledged to the repayment of the GANS. Up to $900,000,000 of said notes may be paid off through the issuance of authorized general obligation bonds of the Commonwealth in the event federal financial assistance is not available. At June 30, 1999, the Commonwealth has $921,720,000 of GANS outstanding, including accrued interest on capital appreciation bonds with maturity dates ranging from 2005 to 2015. These notes are secured by the pledge of Federal Highway Construction reimbursements without a general obligation pledge.

For financial reporting purposes, long-term debt is carried at its face value, which includes discount and any issuance costs financed. The outstanding amount represents the total principal to be repaid. For capital appreciation bonds, the outstanding amount represents total principal and interest to be repaid. When short-term debt has been refinanced on a long-term basis, it is reported as outstanding at its face amount.

The amount of long-term debt authorized but unissued is measured in accordance with the statutory basis of accounting. Only the net proceeds (exclusive of discount and costs of issuance) are deducted from the total authorized by the Legislature.

Long-term debt outstanding (including discount and issuance cost) and debt authorized-unissued at June 30, 1999 are as follows (amounts in thousands):

Purpose	Bonds Outstanding	Maturities	Authorized and Unissued
GANS................	$ 921,720	2005-2015	$ 600,009
Capital Projects:			
General............	5,060,692	1999-2025	5,154,056
Highway...........	4,218,274	1999-2018	5,016,975
Local Aid.........	1,549,075	1999-2017	425,671
Other...............	58,700	1999-2025	807,306
	10,886,741		11,404,008
Total..................	$ 11,808,461		$ 12,004,017

Interest rates on the Commonwealth's debt outstanding at June 30, 1999 ranged from 0.1% to 14.125%.

Changes in long-term debt outstanding (including discount and issuance cost) and bonds authorized - unissued for the year ended June 30, 1999 are as follows (amounts in thousands):

	Bonds Outstanding	Authorized and Unissued
Balance July 1, 1998..........................	$ 11,078,603	$ 12,316,738
General and special obligation bonds:		
Principal, less discount and issuance costs.........................	1,014,806	(1,014,806)
Discount and issuance costs..............	15,684	-
County debt:		
Principal of bonds assumed............	1,505	-
Grant Anticipation Notes:		
Principal, less discount and issuance costs.................	319,434	(319,434)
Discount and issuance costs..............	2,286	-
General obligation refunding bonds:		
Principal of bonds issued.................	499,520	-
Refunded bonds...............................	(464,820)	-
Increase in bonds authorized.............	-	1,513,829
Contributions in lieu of bonds........	-	(492,310)
Bonds retired.......................................	(658,557)	-
Balance June 30, 1999.........................	$ 11,808,461	$ 12,004,017

At June 30, 1999, debt service requirements to maturity for principal (including discount, capital appreciation and
issuance costs) and interest are as follows (amounts in thousands):

Fiscal year ending June 30,	Principal	Interest	Total
2000…………………	$ 675,564	$ 552,554	$ 1,228,118
2001…………………	720,675	517,954	1,238,629
2002…………………	686,631	482,383	1,169,014
2003…………………	701,641	451,722	1,153,363
2004…………………	695,994	421,980	1,117,974
2005 and thereafter.....	8,327,956	2,387,669	10,715,625
Total...........................	$ 11,808,461	$ 4,814,262	$ 16,622,723

The Commonwealth issued bonds and notes under negotiated contracts and under competitive bidding contracts during fiscal year 1999. The costs for legal counsel and underwriting fees under competitive bond sale costs were estimated at $102,000 and $1,666,000 respectively. Negotiated legal fees and underwriter fees were estimated at $182,000 and $5,000,000, respectively. In addition, the Commonwealth paid $80,000 for disclosure counsel services.

Advance Refunding and Defeased Bonds - As authorized by the Massachusetts General Laws, the Commonwealth advance refunded certain general obligation bonds through the issuance of $499,520,000 of general obligation refunding bonds during fiscal year 1999. Proceeds totaling approximately $498,793,000 were used to purchase U. S. Government securities which were deposited in irrevocable trusts with an escrow agent to provide for all future debt service payments of the refunded bonds. As a result, the refunded bonds are considered to be defeased, and the liabilities therefore have been removed from the General Long-term Obligations Account Group. As a result of these advance refundings, the Commonwealth decreased current year debt service payments and has taken advantage of lower interest rates, and it has decreased its aggregate debt service payments by approximately $32,530,000 over the next 20 years and will experience an economic gain (the difference between the present values of the debt service payments of the refunded and refunding bonds) of approximately $24,930,000. At June 30, 1999, approximately $464,820,000 of the bonds refunded remain outstanding and are defeased.

The refunding bonds issued in fiscal year 1999 constituted variable rate demand bonds. The variable rate for those bonds are determined weekly based on the activity of a remarketing agent, and interest is paid monthly. In connection with issuance of the variable rate demand bonds, the Commonwealth has entered into interest rate exchange (“swap”) agreements with certain counterparties. These agreements require the counterparties to pay the Commonwealth an amount equal to the variable rate payable on the bonds and in return the Commonwealth pays a fixed rate. Only the net difference in interest payments is actually exchanged with the counterparty. The bond principal is not exchanged. The Commonwealth continues to pay interest to the bondholders at the variable rate provided by the bonds.

Through these agreements the Commonwealth has effectively fixed its interest payment obligations relative to the variable rate bonds at a rate equal to 4.32%, including the costs of the liquidity facility and remarketing. The Commonwealth will be exposed to a variable rate if the counterparties default or if the swap is terminated. A termination of the swap agreement may also result in the Commonwealth’s making or receiving a termination payment.

The variable rate bonds are supported by a stand-by bond purchase liquidity facility with a commercial bank, which requires that the bank purchase any bonds that are not successfully remarketed and tendered. Until and unless remarketed, the Commonwealth would be required to pay the bank interest on such bonds at a rate equal to the bank’s prime interest rate. In addition, the Commonwealth would be required to repay the principal amount of any such bonds in equal quarterly installments over the remainder of the term of the stand-by bond purchase agreement. As of June 30, 1999 the stand-by bond purchase facility has not been used. The stand-by bond purchase agreement has a stated expiration date of September 2003, but may be renewed or extended by mutual consent of the Commonwealth and the bank. In connection with the agreement the Commonwealth pays a fee equal to 0.10% per year of the principal amount of variable rate bonds outstanding.

In prior years, the Commonwealth also defeased certain general obligation and other bonds by placing the proceeds of refunding bonds in irrevocable trusts to provide for all future debt service payments on the refunded bonds. Accordingly, the trust account assets and the liabilities for the defeased bonds are not included in the financial statements. At June 30, 1999, approximately $2,330,546,000 of bonds outstanding from advance refundings in prior fiscal years are considered defeased.

On October 13, 1999 the Commonwealth defeased $512,565,000 of outstanding debt at maturity issued prior to June 30, 1999. The Commonwealth deposited $400,001,000 of available funds from FY99, pursuant to Chapter 55, Section 7 of the Acts of 1999, into an irrevocable trust to provide for all future debt service payments on bonds. The defeasance resulted in no economic gain or loss.

Statutory Debt Limit –The Massachusetts General Laws establish limits on the amount of direct debt outstanding. By statutorily limiting the Commonwealth's ability to issue direct debt, this limit provides a control on annual capital spending. The direct debt limit for fiscal year 1999 was approximately $10,046,697,000. Outstanding debt subject to the limit at June 30, 1999 was approximately $9,516,320,000. The limit increases 5% per year.

For purposes of determining compliance with the limit, outstanding direct debt is defined to include general obligation bonds and minibonds at the amount of their original net proceeds. It excludes bond anticipation notes and discount and issuance costs, if any, financed by these bonds. It also excludes special obligation bonds, grant anticipation notes, refunded bonds, and certain refunding bonds and debt issued by counties.

The amounts excluded from the debt limit are as follows (amounts in thousands):

	Debt Outstanding
Balance June 30, 1999	$ 11,808,461
Less amounts excluded:	
Discount and issuance cost	(677,326)
Chapter 5 of the Acts of 1992 Refunding	(130,069)
Special Obligation Principal	(582,410)
GANS Principal	(899,991)
County Debt Assumed	(2,345)
Outstanding Direct Debt	$ 9,516,320

7. LEASES

In order to finance the acquisition of equipment, the Commonwealth has entered into various lease/purchase agreements, including tax-exempt lease purchase (TELP) agreements, which are accounted for as capital leases. Lease agreements are for various terms and contain clauses indicating that their continuation is subject to appropriation by the Legislature. For the fiscal year ended June 30, 1999, capital lease/purchase expenditures totaled approximately $63,404,000. At June 30, 1999, the Commonwealth's aggregate outstanding liability under capital leases, the present value of the net minimum lease payments, totals approximately $156,980,000. This liability is reported in the General Long-Term Obligations Account Group. Equipment acquired under capital leases and included in the General Fixed Assets Account Group totaled approximately $143,436,000.

The Commonwealth has numerous operating lease agreements for real property and equipment with varying terms. These agreements contain provisions indicating that continuation is subject to appropriation by the Legislature. Operating lease expenditures for the fiscal year ended June 30, 1999 was approximately $121,003,000.

The following is a schedule of future minimum payments under non-cancelable leases as of June 30,1999 (amounts in thousands):

Fiscal Year Ending June 30,	Capital Leases	Operating Leases
2000	$ 46,462	$ 118,001
2001	38,565	93,949
2002	28,948	75,621
2003	22,030	54,590
2004	14,656	27,187
2005 and thereafter	34,284	286,222
Total	184,945	655,570
Less interest	(27,965)	-
Present value	$ 156,980	$ 655,570

8. INDIVIDUAL FUND DEFICITS

Certain Budgeted, Non-Budgeted Special Revenue and Capital Projects Funds included in the combined totals have individual fund deficits at June 30, 1999, as follows (amounts in thousands):

Budgeted Funds:	
Highway Fund	$ 180,586
Local Aid Fund	2,581,361
Mosquito and Greenhead Fly Control Fund	1,848
Environmental Challenge Fund	4,176
Toxic Use Reduction Fund	4,608
Environmental Permitting and Compliance Assurance Fund	26,947
Environmental Law Enforcement Fund	1,872
Public Access Fund	298
Harbors and Inland Waters Maintenance Fund	2,121
Marine Fisheries Fund	3,814
Low-Level Radioactive Waste Management Fund	307
Clean Air Act Compliance Fund	104
Second Century Fund	4,124
Anti-trust Law Enforcement Fund	2,188
Victim and Witness Assistance Fund	5,653
Intercity Bus Capital Assistance Fund	7,084
Ponkapoag Recreational Fund	77
Leo J. Martin Recreation Fund	194
Division of Insurance Fund	651
Social Services Program Fund	269
Local Consumer Inspection Fund	296
	2,828,578
Non-Budgeted Special Revenue:	
Other:	
Government Land Bank Fund	35,097
Child Suport Enforcement Fund	854
	35,951
Capital Projects:	
Boston Convention and Exhibition Center Fund	19,000
Highway Fund	257,944
Local Aid Fund	20,779
Water Pollution Control Fund	5,447
State Recreation Areas Fund	102
Metropolitan Parks Fund	4,095
Government Land Bank Fund	11,000
	318,367
Total	$ 3,182,896

In order to resolve the deficits in the budgeted funds, the Comptroller has recommended authorization of transfers from other budgeted funds with surplus balances or a plan of fund consolidation. If these changes are adopted by the legislature, the deficiencies will be resolved. For the Non-Budgeted Special Revenue Funds, the Comptroller has recommended similar budgeted transfers to subsidize and resolve the deficits or their consolidation into budgeted funds. Such steps require legislative action.

In the Capital Project Funds, the deficit of $318,367,000 reflects the time lag between capital expenditures and the receipt or allocation of proceeds from the sale of related bonds. Subsequent to June 30, 1999, the Commonwealth issued $500,000,000 in general obligation bonds to finance the deficit.

9. MEDICAID COSTS

The Commonwealth provides medical care for low-income, elderly and other residents who qualify for such assistance under the federally-sponsored Medical Assistance Program (Medicaid). The Commonwealth pays the full cost of care and is reimbursed by the federal government for 50% of that cost. For the fiscal year ended June 30, 1999, the General Fund and Children's and Senior's Health Fund include $3,856,453,000 in expenditures for Medicaid claims processed for payment.

The combined financial statements – statutory basis include Medicaid claims processed but unpaid at June 30, 1999, as accounts payable of approximately $88,407,000. The Commonwealth estimates its total liability, as determined in accordance with generally accepted accounting principles, at $587,220,000 including the amounts reported as accounts payable at June 30, 1999. This amount includes estimates of both the cost of care provided as of June 30, 1999, for which claims have not been processed and other costs. Of this amount, $274,635,000 is expected to be reimbursed by the federal government.

10. RETIREMENT SYSTEMS

Primary Government **–** The Commonwealth is statutorily responsible for the pension benefits for Commonwealth employees (members of the State Employees' Retirement System) and for teachers of the cities, towns, regional school districts throughout the Commonwealth and Quincy College (members of the Teachers' Retirement System, except for teachers in the Boston public schools, who are members of the State-Boston Retirement System but whose pensions are also the responsibility of the Commonwealth).

The members of the retirement systems do not participate in the Social Security System. The Commonwealth has assumed responsibility for payment of cost-of-living adjustments (COLA) for the separate (non-teacher) retirement systems of its cities, towns and counties, granted in fiscal year 1997 and prior. The Commonwealth is statutorily required to have an actuarial valuation once every three years and every two years on a GAAP basis.

Certain Commonwealth employees and current retirees employed prior to the establishment of the State Employees' Retirement System are covered on a "pay-as-you-go" basis.

Plan Descriptions –

State Employees' Retirement System (SERS) is a single employer defined benefit public employee retirement system (PERS), covering substantially all employees of the Commonwealth and certain employees of the independent authorities and agencies including the state police officers at the Massachusetts Port Authority and the Massachusetts Turnpike Authority. The SERS is administered by the Commonwealth and is part of the reporting entity and does not issue a stand alone financial report.

Teachers' Retirement System (TRS) is an agent multiple employer defined benefit PERS with 104 participating employers. The Commonwealth is a non-employer contributor and is responsible for all contributions and future benefit requirements of the TRS. The TRS covers certified teachers in cities (except the City of Boston), towns, regional school districts and Quincy College. The TRS is administered by the Commonwealth and is part of the reporting entity and does not issue a stand-alone financial report.

State – Boston Retirement System (SBRS) is hybrid multiple employer defined benefit PERS. SBRS provides pension benefits to all full-time employees upon commencement of employment with any of the various government agencies covered by SBRS. The Commonwealth is a non-employer contributor and is only responsible for the actual cost of pension benefits for SBRS participants who serve in the City of Boston's School Department in a teaching capacity. The cost of pension benefits of the other participants is the responsibility of the City of Boston. SBRS is not administered by the Commonwealth and is not part of the reporting entity and a stand-alone financial report is not available.

The policy for postretirement benefit increases for all retirees of the SERS, TRS, SBRS and COLA are subject to legislative approval.

Membership – Membership in SERS, TRS and SBRS as of January 1, 1998, the date of the most recent valuation, is as follows:

	SERS	TRS	SBRS
Retirees and beneficiaries currently receiving benefits................	43,144	30,499	2,742
Terminated employees entitled to benefits but not yet receiving them....	2,073	1,850	96
Subtotal..	45,217	32,349	2,838
Current employees:			
Vested..	48,035	50,477	4,181
Non-vested...	34,596	24,422	1,269
Subtotal..	82,631	74,899	5,450
Total...	127,848	107,248	8,288

During fiscal year 1998, the Commonwealth abolished Franklin and Middlesex Counties and in fiscal year 1999 the Commonwealth abolished Worcester, Hampden and Hampshire counties, transferring their functions, assets, debts and obligations to the Commonwealth. The SERS actuarial accrued liability includes former county employees who were transferred to the Commonwealth.

Benefit Provisions – Massachusetts General Laws established uniform benefit and contribution requirements for all contributory PERS. These requirements provide for retirement allowance benefits up to a maximum of 80% of a member's highest three-year average annual rate of regular compensation. Benefit payments are based upon a member's age, length of creditable service, and group classification. The authority for amending these provisions is with the legislature.

Retirement allowance consists of two parts: an annuity and a pension. A member's accumulated total deductions and a portion of interest they generate constitute the annuity. The differential between the total retirement benefit and the annuity is the pension. Average retirement benefit is approximately 80-85% pension and 15-20% annuity.

Members become vested after ten years of creditable service. A superannuation retirement allowance may be received upon the completion of twenty years of service or upon reaching the age of 55 with ten years of service. Normal retirement for most employees occurs at age 65; for certain hazardous duty and public safety positions, normal retirement is at age 55.

Funding Progress - The SERS, TRS and SBRS actuarial determined contributions were computed as part of the actuarial valuation as of January 1, 1998. The Commonwealth had revised three actuarial assumptions used in the calculation of contribution requirements and Unfunded Actuarial Liability (UAL). First, the assumed rate of return on investments of present and future assets was changed from 8.5% to 8.25% per year resulting in a $641,000,000 increase in the UAL. Second, the use of an updated mortality table resulted in a $1,100,000,000 increase in the UAL. Third, a change from using the market value of assets to an actuarial value of assets had the effect in this valuation of reporting assets at 97% of the market value. This third change results in a $643,000,000 increase in UAL. Other significant assumptions used are (a) projected salary increases of 6% per year, (b) cost of living (inflation rate) increases of 3% per year on the first $12,000 of the retirees total allowance, and (c) interest rate credited to the annuity savings fund of 5.5% per year. These calculations use a level dollar amortization method over 20 years closed period.

The following table presents the schedule of funding progress as presented in the five most recent actuarial valuations at the dates indicated (amounts in thousands):

Actuarial Valuation as of January 1,	Actuarial Value of Plan Assets	Actuarial Accrued Liability	Unfunded Actuarial Liability (UAL)	Funded Ratio %	Annual Covered Payroll *	UAL as a % of Covered Payroll
State Employers Retirement System						
1998**	$ 9,914,000	$ 11,361,000	$ 1,447,000	87.3 %	$ 3,111,000	46.5 %
1996	7,366,000	9,441,000	2,075,000	78.0	2,989,000	69.4
1995	5,879,000	8,602,000	2,723,000	68.3	2,992,000	91.0
1993	5,071,000	8,738,000	3,667,000	58.0	2,919,000	125.6
1992	4,699,000	7,303,000	2,604,000	64.3	2,638,000	98.7
Teachers Retirement System						
1998**	10,170,000	13,095,000	2,925,000	77.7	3,175,000	92.1
1996	7,553,000	10,252,000	2,699,000	73.7	2,810,000	96.0
1995	6,014,000	9,712,000	3,698,000	61.9	2,667,000	138.7
1993	5,142,000	8,921,000	3,779,000	57.6	2,428,000	155.6
1992	4,784,000	8,706,000	3,922,000	55.0	2,032,000	193.0
State - Boston Retirement System						
1998**	699,000	1,219,000	520,000	57.3	285,000	182.5
1996	549,000	1,025,000	476,000	53.6	274,000	173.7
1995	438,000	833,000	395,000	52.6	232,000	170.3
1993	370,000	743,000	373,000	49.8	206,000	181.1
1992	342,000	759,000	417,000	45.1	184,000	226.6

* - The covered payroll amounts approximate the employer payroll.
** - Revised actuarial assumptions

In addition to these system liabilities, the Commonwealth had assumed financial responsibility for the COLA granted to participants in the 104 retirement systems of cities, towns and counties in fiscal year 1997 and prior fiscal years. Chapter 17 of the Acts of 1997 effective for fiscal year 1998 transferred the responsibility for funding COLAs for separate (non-teacher) retirement systems of cities and towns to the respective system. Any future COLA granted by the Legislature to employees of these plans will be the responsibility of the individual system. The individual employer governments are also responsible for the basic pension benefits. The retirement systems are not administered by the Commonwealth and are not part of the reporting entity. The actuarial accrued liability for COLA as of January 1, 1998 was $912,029,000.

Contributions Required and Contributions Made – The retirement systems' funding policies have been established by Chapter 32 of the Massachusetts General Laws. The legislature has the authority to amend these policies. The annuity portion of the SERS, TRS and

SBRS retirement allowance is funded by employees, who contribute a percentage of their regular compensation – 5% for those hired before January 1, 1975, 7% for those hired from January 1, 1975, through December 31, 1983 and 8% for those hired on or after January 1, 1984, plus an additional 2% of compensation above $30,000 per year for those hired on or after January 1, 1979. Regular employees and state police hired after June 30, 1996 are required to contribute 9% and 12% respectively of their regular compensation plus an additional 2% of compensation above $30,000 per year. Costs of administering the plan are funded out of plan assets.

The Commonwealth's contribution for the pension benefit portion of the retirement allowance of SERS and TRS and required payments to cover SBRS and COLA contributions were originally established on a "pay-as-you-go" basis. As a result, amounts were appropriated each year to pay current benefits, without a systematic provision to fully fund future liabilities already incurred. Beginning in fiscal year 1988, the Commonwealth enacted the Pension Reform Act of 1987 and addressed the unfunded liability of SERS, TRS and its participation in SBRS and its COLA obligation. Chapter 32, Section 22C of General Laws enacted in 1998 calls for the payment of normal cost plus an amortization payment of UAL such that the UAL is reduced to zero by June 30, 2018.

This legislation also directs the Secretary of Administration and Finance to prepare a funding schedule to meet these requirements, and to update this funding schedule every three years on the basis of new actuarial valuation reports prepared under the Secretary's direction. Any such schedule is subject to legislative approval. If a schedule is not so approved, payments are to be made in accordance with the most recently approved schedule.

The current legislatively approved funding schedule, based on the October 26, 1998 valuation, was adopted by the Legislature as part of the fiscal year 1999 budget process. Under the current schedule the amortization payments are designed to eliminate the unfunded liability by fiscal year 2018. Based on the previous funding schedule required contributions by the Commonwealth of $945,340,000 during the fiscal year ended June 30, 1999. Of this amount $124,494,000 represents payments for COLA granted to participants in retirement systems of cities, towns and counties.

GAAP requires that pension expenditures (costs) be based on an acceptable actuarial cost method and that they be not less than:

- Normal cost and amortization cost
- Interest and amortization on any unfunded prior service costs

The funding schedule discussed above follows an acceptable actuarial funding methodology to compute normal cost and the unfunded accrued actuarial liability.

Pension Actuarial Valuation **–** On April 28, 1999 a pension valuation report prepared by independent actuarial consultants to the Pension Reserves Investment Management (PRIM) Board was released. Using the same data and assumptions employed by PERAC in its October, 1998 valuation report, the independent report found the unfunded actuarial liability to be $6.346 billion (rather than $4.371 billion) for state employees and state teachers and $583.3 million (rather than $519.9 million) for Boston teachers. The total unfunded liability which includes cost of living adjustments totaled $7.841 billion rather than $5.803 billion. Neither PERAC nor the independent consultants to the PRIM Board have yet determined the source of the differences.

The following table presents the schedule of employer contributions (amounts in thousands):

Actuarial Valuation as of January 1,	Annual Required Contribution (ARC)	Interest on NPO	Amortization of NPO	Pension Cost	Actual Contribution Made	Net Pension (Obligation) Asset (NPO)	% of ARC Contributed	% of Pension Cost Contributed
State Employers Retirement System								
*1998	$ 261,255	$ (83,446)	$ 77,180	$ 254,989	$ 494,289	$ 1,250,766	189 %	194 %
1997	246,037	(65,478)	41,889	222,448	463,590	1,011,466	188	208
1996	232,158	(46,918)	29,523	214,763	433,114	770,324	187	202
1995	249,640	(31,639)	19,614	237,615	417,361	551,973	167	176
1994	266,564	(18,448)	9,152	257,268	398,900	372,227	150	155
1993	243,587	(5,539)	2,694	240,742	402,100	230,595	165	167
1992	252,687	136	(65)	252,758	323,700	69,237	128	128
1991	282,682	2,335	(1,094)	283,923	311,400	(1,705)	110	110
1990	259,102	4,569	(2,103)	261,568	289,500	(29,182)	112	111
1989	298,800	2,160	(977)	299,983	269,866	(57,114)	90	90
1988	279,582	-	-	279,582	252,585	(26,997)	90	90
Teachers Retirement System								
*1998	315,474	(59,126)	54,686	311,034	446,619	852,267	142	144
1997	245,426	(44,832)	28,681	229,275	418,519	716,682	171	183
1996	232,403	(30,311)	19,073	221,165	392,003	527,439	169	177
1995	277,343	(24,002)	14,880	268,221	342,441	356,601	123	128
1994	247,460	(15,975)	7,925	239,410	322,100	282,381	130	135
1993	225,838	(9,946)	4,837	220,729	296,100	199,691	131	134
1992	223,041	(4,996)	2,384	220,429	282,300	124,320	127	128
1991	249,436	(3,452)	1,617	247,601	266,900	62,449	107	108
1990	227,270	(1,459)	671	226,482	251,400	43,150	111	111
1989	249,108	(1,595)	722	248,235	246,531	18,232	99	99
1988	232,661	-	-	232,661	252,597	19,936	109	109
State-Boston Retirement System								
*1998	48,795	(2,114)	1,995	48,636	35,000	11,983	72	72
1997	34,621	(2,082)	1,332	33,871	35,000	25,619	101	103
1996	32,908	(1,860)	1,171	32,219	34,822	24,490	106	108
1995	28,168	(1,816)	1,126	27,478	28,000	21,887	99	102
1994	22,448	(1,216)	603	21,835	28,000	21,365	125	128
1993	20,463	(650)	316	20,129	27,200	15,200	133	135
1992	26,530	(634)	303	26,199	26,400	8,129	100	101
1991	23,149	(413)	193	22,929	25,700	7,928	111	112
1990	21,118	(251)	116	20,983	23,000	5,157	109	110
1989	21,744	(127)	58	21,675	23,225	3,140	107	107
1988	20,315	-	-	20,315	21,905	1,590	108	108

* Last year for which an actuarial valuation has been completed.

The total contributions required for SERS, TRS and SBRS are based on the entry age normal cost method using the same actuarial assumptions used to compute the net pension obligation.

During the year ended June 30, 1999, the Commonwealth's pension expenditure included payments totaling $19,310,000 to current retirees employed prior to the establishment of the current plans and the non-contributory plans.

Post-retirement Health Care and Life Insurance Benefits – In addition to providing pension benefits, under Chapter 32A of the Massachusetts General Laws, the Commonwealth is required to provide certain health care and life insurance benefits for retired employees of the Commonwealth, housing authorities, redevelopment authorities, and certain other governmental agencies. Substantially all of the Commonwealth's employees may become eligible for these benefits if they reach retirement age while working for the Commonwealth. Eligible retirees are required to contribute a specified percentage of the health care benefit costs which is comparable to contributions required from employees. The Commonwealth is reimbursed for the cost of benefits to retirees of the eligible authorities and non-state agencies. The Commonwealth recognizes its share of the costs of providing these benefits when paid. These payments totaled approximately $182,541,000 for the fiscal year ended June 30, 1999. There are approximately 45,100 participants eligible to receive benefits at June 30, 1999.

11. COMMITMENTS

Under Chapters 161A and 161B of the General Laws, the Commonwealth is obligated to provide annual subsidies to the MBTA and certain regional transit authorities for contract assistance, debt service assistance and their net cost of service deficiencies. The Commonwealth recovers a portion of these payments through assessments to the cities and towns served. During fiscal year 1999, net expenditures were $499,093,000 and $38,618,000, respectively. For fiscal year 2000, the Commonwealth has appropriated $555,815,000 and $40,192,000 to the MBTA and regional transit authorities, respectively. These appropriations cover net costs of service for the calendar year ended December 31, 1998.

The Commonwealth is also statutorily obligated to provide contract assistance for debt service obligations to the Massachusetts Convention Center Authority, the Massachusetts Development Finance Authority and the Water Pollution Abatement Trust. Such assistance totaled $63,467,000 in fiscal year 1999. For fiscal year 2000, appropriations for this purpose totaled $76,853,000.

At June 30, 1999, the aggregate outstanding debt for which the Commonwealth is obligated to provide contract assistance support totaled approximately $3,569,077,000 long-term and $396,441,000 short-term. In addition, the Commonwealth guarantees the debt of certain local governments and public higher education building authorities. The guaranteed long-term debt outstanding at June 30, 1999 was approximately $216,206,000.

At June 30, 1999, the Commonwealth had commitments of approximately $3,027,529,000 construction projects. The majority relate to construction funding for a major infrastructure project known as the Central Artery/Tunnel Project. The Central Artery/Tunnel Project continues to anticipate federal participation and payments from the Massachusetts Turnpike Authority (MTA) and the Massachusetts Port Authority (MassPort).

During fiscal year 1999, the Commonwealth received payments from MTA and MassPort pursuant to three separate memoranda of understandings dated September 12, 1997 and August 13, 1998 and February 19, 1999 respectively. The MTA and MassPort made payments to the Commonwealth to finance portion of the Central Artery/Tunnel Project in the amount of $1,055,000,000 and $30,735,000 respectively.

Fiscal Year	MTA	MassPort
2000..........	$100,000	$52,236
2001..........	-	-
2002..........	-	-
2003..........	-	-
2004..........	-	105,000
2005..........	-	50,000
2006..........	-	50,000
Total..........	$100,000	$257,236

The remaining future payments are as follows:
(Amounts in thousands)

12. CONTINGENCIES

A number of lawsuits are pending or threatened against the Commonwealth which arose from the ordinary course of operations. These include claims for property damage and personal injury, breaches of contract, condemnation proceedings and other alleged violations of law. For those cases in which it is probable that a loss will be incurred and the amount of the potential judgment can be reasonably estimated or a settlement or judgment has been reached but not paid, the Attorney General estimates the liability to be approximately $32,700,000 which is expected to be paid in fiscal year 2000. No accrual has been made for this amount in the combined financial statements – statutory basis.

Workers' compensation costs are recognized when claims are presented and paid. The Commonwealth's outstanding liability for such claims at June 30, 1999, is estimated to be $261,600,000, of which approximately $36,400,000 is expected to be paid during fiscal year 2000. No accrual has been made for these amounts in the combined financial statements – statutory basis.

The Commonwealth receives significant financial assistance from the federal government. Entitlement to these resources is generally conditional upon compliance with terms and conditions of the grant or reimbursement agreements and with applicable federal regulations, including the expenditure of the resources for eligible purposes. Substantially all federal financial assistance is subject to financial and compliance audits. Any disallowances become liabilities of the fund which received the assistance. At June 30, 1999, the Commonwealth estimated that liabilities, if any, which may result from such audits are not material.

Chapter 200A of the Massachusetts General Laws, the Commonwealth's Abandoned Property Law, requires deposit of certain unclaimed assets into a managed Fiduciary Fund (the "Unclaimed Check Fund"). These unclaimed assets, less $4,742,000, which is expected to be reclaimed and paid in fiscal year 2000, are to be remitted to the General Fund each June 30, where it is included as miscellaneous revenue. Amounts remitted during fiscal year 1999 totaled approximately $64,723,000. Since inception, approximately $821,616,000 has been remitted. A portion of this amount represents a contingency, because claims for refunds can be made by the owners of the property.

Unclaimed Check Fund – In February 1999 former employees of the State Treasurer's Office were charged with attempting to embezzle $6.5 million from the Unclaimed Check fund. These funds have been recovered by the Commonwealth. The Attorney General is conducting a criminal investigation of the matter and believes that the likelihood of loss by the Commonwealth in excess of $20 million is remote. The grand jury formally indicted the individuals in September 1999.

Tobacco Settlement – On November 23, 1998, the Commonwealth joined a multi-state agreement, known as the Master Settlement Agreement ("MSA") which resolved the Commonwealth's and other states' litigation against the cigarette industry. Under the MSA, annual payments are made to each settling state, including the Commonwealth in perpetuity. The Superior Court of the Commonwealth approved the MSA and entered a Consent Decree and Final Judgement on December 4, 1998. The 60-day appeal period for these orders expired on February 2, 1999 with no appeal filed.

Under the MSA, there are five "initial payments" to be paid annually by the cigarette industry to the Commonwealth. In addition, a separate stream of annual payments is made in perpetuity. These payments should begin no later than July 15, 2000. On December 28, 1998, the companies timely made their first payment into the escrow account established under the MSA, in the amount of $2.4 billion, which is to be apportioned among the states that have settled, including the Commonwealth.

The Commonwealth's allocable share of the total amounts payable under the MSA is 4.038979%. The Attorney General has estimated that over the initial 25-year period, $7.59 billion could be received under the settlement. The initial payment due to the Commonwealth for calendar 1999 is approximately $98 million, and the initial and annual payment for calendar 2000 is approximately $259 million.

The annual payments under the MSA are subject to various adjustments and contingencies. The initial adjustment will be upward by 3% or the amount of the Consumer Price Index (whichever is greater). Other adjustments might occur based on changes in domestic cigarette sales volume or, as a decrease, based upon funding made available to the states under qualifying federal legislation.

The MSA includes a secondary fund, a "Strategic Contribution" fund, totaling $8.61 billion. Proceeds will be allocated, based on an arbitration decision on May 21, 1999 to the states over the period 2008 through 2017. Massachusetts was awarded $414 million, which will be payable in equal installments during the years 2008 through 2017.

The amounts that might be payable, if any, by the Commonwealth for the legal costs incurred in relation to the tobacco litigation cannot be determined at this time.

In the various budgets submitted for fiscal 2000 from the Governor, the General Court and the Senate, all agree that health care initiatives in the Commonwealth would be the major beneficiary of settlement funds. The Budgets differ as to timing, mechanism and allocation.

13. NON-TAX REVENUE INITIATIVES

Chapter 653, Acts of 1989, amended Chapter 29 of the Massachusetts General Laws by adding Sections 29D and 29E, which authorize certain non-tax revenue initiatives and require reporting thereon, as follows.

Debt Collection Pursuant to Massachusetts General Laws Chapter 29, Section 29D, Chapter 7A Section 8, allows private debt collection agencies to engage in debt collection for the Commonwealth. The fees paid are contingency based from the proceeds collected. Collections and fees paid during fiscal year 1999 were:

Department Collectors	Collections	Fees
Allen Daniel Associates	$ 93,119	$ 16,605
Collection Company of America	683,181	155,959
Gragil Associates	156,299	33,135
Payco	556,576	133,668
Walker Associates	815,177	120,217
Windham Professionals	725,547	159,893
Total	$ 3,029,899	$ 619,477

Under a similar program for the Commonwealth's public institutions of higher education, the following amounts were collected and fees paid:

Department Collectors	Collections	Fees
Allen Daniel Associates	$ 694,257	$ 121,815
Associated Credit Services	540	103
Collection Company of America	1,681,155	527,424
Financial Collection Agency	23,720	2,899
Glenn Associates	471,769	91,939
Gragil Associates	17,980	4,508
Payco	421,112	100,683
Walker Associates	1,646	343
Windham Professionals	254,746	25,131
Total	$3,566,925	$ 874,845

Revenue Maximization – Pursuant to Massachusetts General Law Chapter 29 Section 29E and Chapter 194 Section 276 of the fiscal year 1999 Budget, contractors were engaged on a contingent fee basis to assist several of the Commonwealth's departments in the identification and collection of federal and other revenues. During fiscal year 1999, approximately $159,772,000 was collected through such efforts. After contractor fees of $13,902,000 were paid on a contingent basis, the Commonwealth received approximately $145,870,000.

Pursuant to Chapter 194 of Section 348 of the fiscal year 1999 Budget, the Comptroller's Office is authorized to engage vendors for the purpose of identification and pursuit of cost savings/avoidance opportunities. For fiscal year 1999 there was one department engaged in a Section 348 procurement/project. In fiscal year 1999, estimated total cost avoidance based on actuarial calculations was approximately $68,828,000 and fees paid to the Public Consulting Group were $2,901,000.

Utility Audits – Massachusetts General Law, Chapter 20 Section 29G, authorizes the Department of Procurement and General Services to solicit services and enter into contingent contracts on behalf of governmental entities for the potential of recoupment of overcharges associated with utility expenses. During fiscal year 1999, approximately $218,000 was recouped and $107,000 was paid or payable to the Cost Control Associates and the Utility Management Group, resulting in a net benefit to the Commonwealth of approximately $111,000. As of June 30, 1999, reviews were in process for 12 municipalities who have taken advantage of the master service agreement negotiated by Procurement and General Services.

14. SUBSEQUENT EVENTS

Subsequent to year-end, two additional counties will be abolished.

The county of Essex will be transferred July 1, 1999, (FY00); and the county of Berkshire will be transferred on July 1, 2000 (FY01). The transfer date can be earlier if a county has failed to make a required payment on an outstanding bond or note. The Commonwealth will include in its audited financial statements the financial activity of an abolished county in the fiscal year the actual transfers occur.

Footnote six discusses additional long-term debt activity after June 30, 1999. Footnote twelve discusses activity regarding Tobacco Settlement and Unclaimed Check Fund.